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ABSTRACT

The term "school finance" refers to the levying of taxes to obtain revenue for our public elementary and secondary schools. For most people it brings to mind the local property tax, teacher salaries, and, perhaps, some personal memories of their own experiences in the schools. For state legislators school finance brings to mind the complex formula through which considerable amounts of tax dollars are distributed to school districts. It is apparent that school finance represents the bringing together of two of our major institutions--politics and education. This brief overview of finance reform has been written for legislators. It is intended to point to one very obvious fact--that when it comes to school finance reform, the building of adequate and equitable finance systems, the spotlight is on the state legislature even though the federal government and the courts play large roles. (Author/IRT)

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School Finance Reform: The Whys and Wherefores

Special Report Number FB
From the ECS Education Finance Center

Prepared by Carol Andersen
Department of Research and Information Services
Russell B. Vlaanderen, Director

Education Commission of the States
Denver, Colorado 80203
Wendell H. Pierce, Executive Director

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Preface

This is a little publication dealing with a large and complex field. It was written for legislators, particularly for the new legislators elected in the fall of 1974, to provide them with a short, readable discussion of school finance reform—the pressures for reform and the response to those pressures.

Perhaps it is not necessary to point to the obvious—that this brief treatment of school finance reform is less than comprehensive. There are, however, a number of publications that are. A list of suggested readings is included, and there are a number of references noted in the text that will supply the reader with sources of further information.

The School Finance Project staff of the Education Commission of the States will be happy to provide additional assistance upon request. Please direct any inquiries you may have to:

Carol Andersen, Research Associate
School Finance Project
Department of Research and Information Services
Education Commission of the States
Suite 300, 1860 Lincoln Street
Denver, Colorado 80203

School Finance Reform: The Whys and Wherefores

The term "school finance" refers to the levying of taxes to obtain revenue for our public elementary and secondary schools. For most people it brings to mind the local property tax, teacher salaries and, perhaps, some personal memories of their own experiences in the schools. For state legislators it brings to mind the complex formula through which state revenues are distributed to school districts and the considerable amounts of tax dollars that are channeled through it each year.

If these two perspectives are put together, it becomes apparent that school finance represents the bringing together of two of our major institutions—politics and education. Both state and local taxes are required to fund our more-than-$50-billion-a-year education system. The *adequacy* of the finance system determines to a significant degree the extent to which education objectives can be implemented. The *equity* of the finance system determines how evenly the cost of education will be distributed among taxpayers and how evenly the resources for education will be distributed among children.

At the School District Level

In the United States the first source of revenue for the public schools is the local property tax. It is "first" for a couple of reasons: (1) it is the major source of education revenue and (2) state aid for education is, in most states, distributed inversely to local property tax wealth. The education finance system, in other words, revolves around the local property tax.

School districts are empowered by the state to levy property taxes for their support at whatever rate they desire, but within the limitations prescribed by state law. Property tax levies provide over 50 per cent of education revenue (see Table 1). One of the major features of the local property tax as a source of revenue is that it can be adjusted at the local level in accordance with local needs and preferences.

Table 1
Estimated Revenue Receipts in Percentages for Elementary and Secondary Schools by Governmental Source, 1972-73

	Local	State	Federal		Local	State	Federal
Alabama	18.9	63.6	17.6	Nebraska	75.8	17.4	6.7
Alaska	11.7	72.4	15.9	Nevada	52.1	42.0	5.9
Arizona	54.3	38.4	7.4	New Hampshire	89.8	6.1	4.1
Arkansas	36.7	48.0	15.3	New Jersey	68.7	26.6	4.7
California	56.5	36.7	6.8	New Mexico	18.9	63.0	18.2
Colorado	64.3	28.0	7.7	New York	52.6	41.4	6.0
Connecticut	73.8	23.1	3.1	North Carolina	20.8	63.7	15.6
Delaware	23.9	68.8	7.3	North Dakota	59.1	29.2	11.7
Florida	35.3	53.9	10.8	Ohio	61.2	33.1	5.7
Georgia	34.5	53.3	12.3	Oklahoma	42.2	47.4	10.4
Hawaii	3.0	89.0	8.0	Oregon	75.6	19.9	4.5
Idaho	48.0	39.3	12.7	Pennsylvania	46.2	47.5	6.3
Illinois	55.2	38.6	6.2	Rhode Island	53.8	37.4	8.9
Indiana	63.8	31.3	5.0	South Carolina	27.9	54.8	17.3
Iowa	63.6	32.7	3.7	South Dakota	72.3	15.1	12.7
Kansas	64.6	27.4	8.0	Tennessee	41.9	45.1	13.1
Kentucky	29.1	55.1	15.8	Texas	43.0	46.3	10.7
Louisiana	29.7	55.6	14.7	Utah	37.9	53.0	9.1
Maine	56.2	34.5	9.3	Vermont	60.9	33.0	6.1
Maryland	45.3	47.8	6.9	Virginia	50.0	39.7	10.4
Massachusetts	70.7	24.2	5.2	Washington	44.0	47.2	8.7
Michigan	48.6	47.6	3.8	West Virginia	31.7	55.9	12.4
Minnesota	40.5	55.0	4.5	Wisconsin	64.5	31.7	3.8
Mississippi	24.2	48.9	26.9	Wyoming	61.3	30.7	7.9
Missouri	56.8	34.9	8.3	United States	51.2	41.0	7.7
Montana	66.3	25.2	8.5				

Source: Advisory Commission on Intergovernmental Relations

As the information in Table 1 indicates, the role of local funding varies a good deal from state to state. In Hawaii, where education has traditionally been supported by state taxes, only three per cent of public school revenue is produced at the local level.[1] At the other end of the scale are states like Nebraska and Oregon, with over 75 per cent of education funds raised at the local level. In New Hampshire, close to 90 per cent of education revenue is obtained from local taxation.

Local officials arrive at a property tax rate (usually referred to as a mill levy) on the basis of (1) estimated expenditures and (2) the assessed valuation of the property in their district. If estimated expenditures are high (a large number of students for example) and the assessed value of property is low, the rate must necessarily be high—compared to the rate in districts where circumstances are more fortuitous.

Variations in tax rates result in taxpayer inequities. Property tax payments on homes vary from district to district, even though they have the same assessed valuation. It is possible, for example, for a taxpayer in District A to pay twice the amount of tax on his $10,000 home as a taxpayer in District B will pay on his $10,000 home simply because the mill rate in District A is twice as high as it is in District B.

Differences in rates may be due to differences in (1) the size of the student population, (2) the value of the property tax base and (3) local costs (for transportation, salaries, fuel and so forth). Spending levels may also be affected by attitudes regarding the value of education, although it has been shown that differences in education spending are associated with differences in property wealth—that districts with the greatest wealth tend to spend the most for education.[2]

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[1] Hawaii is unique in that it has a unified statewide school system. Public schools are supported directly by legislative appropriations.

[2] See pages 71-72 of *Reforming School Finance* by Robert D. Reischauer and Robert W. Hartman (Washington, D.C.: The Brookings Institution, 1973).

Another source of inequity to taxpayers stems from assessment practices. It is customary to assess property at some percentage of its true market value for tax purposes. (This practice is referred to as *fractional assessment.*) In itself, fractional assessment would present no problem providing that the properties within each district were assessed *at the same percentage of market value.* However, uniform assessment is comparatively rare.[3] Many taxing jurisdictions simply lack the resources to maintain an adequate number of trained assessors, and when this is the case, assessments are often inaccurate and inequitable.

Obviously, variations in property tax wealth result in inequities for children as well as taxpayers. While the taxpayers in "property rich" District B may be able, at a modest rate, to provide teaching specialists, libraries and gymnasiums—whatever they feel will make a contribution to their children's education—the taxpayers in "property poor" District A may be taxing themselves at a high rate and still be unable to raise enough revenue to provide more than basic necessities. There have been instances in which state and local revenues combined have not been sufficient to keep the schools of some districts operating throughout the school year.[4]

An example is in order:

	Assessed Value Per Pupil	Tax Rate	Per-Pupil Expenditure
District A	$ 3,706.00	$5.48 for each $100 assessed value	$ 577.49
District B	$50,885.00	$2.38 for each $100 assessed value	$1,231.72

These figures are taken from two school districts in the metropolitan Los Angeles area—Baldwin Park (District A) and Beverly Hills (District B)—for the school year 1968-69. They were provided by the defendants in Serrano v. Priest, the case which paved the way for school finance reform efforts in California. This case is discussed further on page 8 and pages 9-10. The tax rates cited above would be equivalent to 54.8 mills and 23.8 mills for Districts A and B respectively.

[3] For a readable analysis of assessment practices and problems, see Alan Stauffer's *Property Assessment and Exemptions: They Need Reform* (Denver, Colo.: Education Commission of the States, 1973).

[4] An interesting account of a school district with severe financial problems appears in the Feb. 19, 1973, issue of *Time*, "Detroit's Schools Head Toward Disaster," pp. 72-74.

At the State Level

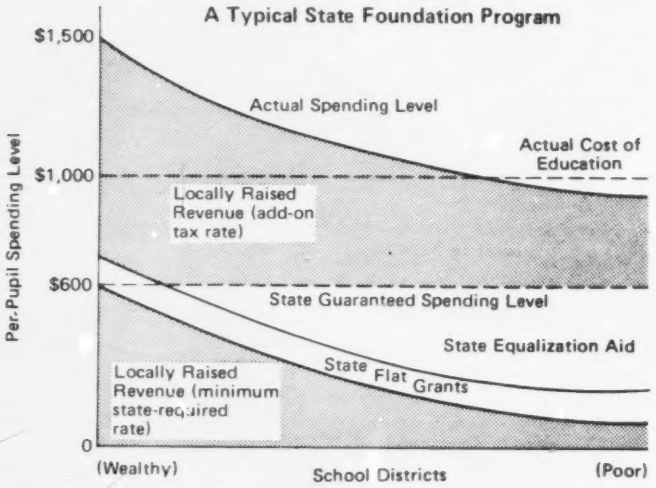
These problems of inadequacy and inequity have been recognized for years. Studies conducted in the early 1900s showed that large differences existed in local tax rates and in the amount of revenue per pupil they provided. In 1923 the "Strayer-Haig foundation program plan" was introduced to deal with these problems and, in subsequent years, it was adopted in some form or another by most states.

Theoretically, a foundation program is one which provides state funds to school districts inversely to their property tax wealth. Districts with a relatively high-assessed valuation behind each student receive less in the way of state aid than do districts with low-assessed valuation per pupil. The foundation formula is based on some specified minimum per-pupil expenditure (the foundation level of support), which is guaranteed to each district that taxes itself at some state-determined minimum tax rate.

Although a properly functioning foundation program (one which resulted in an adequate per-pupil spending level for a reasonable tax effort) would go far towards correcting the problems which result from local financing, it would not result in a perfectly equitable system. Our taxpayers in District A and District B would still not be on equal footing when it came to improving and enriching their schools systems beyond the state guaranteed level.

Generally speaking, however, foundation programs do not function perfectly. In many states, the level of funding results in a guaranteed per-pupil minimum which sometimes does not cover the actual costs of education. As a result, many districts are forced to tax themselves at a rate above the state-required minimum in order to keep their schools in operation. It is in the vagaries of local decision making regarding tax rates, combined with differences in local wealth, that the inequities of school finance systems reside. Foundation programs reduce the magnitude of these inequities, but they do not eliminate them.

Then too, state education funds are not all channeled through the equalization formula of the foundation program. Most states provide flat per-pupil grants to each district regardless of wealth. Since the amount received from flat grants is subtracted from the district's foundation grant, their impact is to weaken the foundation program.



In this state, the foundation level of support is $600 per child while actual costs per pupil are approximately $1,000. The shaded areas indicate revenue from the local property tax; unshaded areas represent state aid from flat grants and from the foundation program.

In addition, state funds are often provided for special education, vocational education, compensatory education and a number of other high-cost programs. States may also offer assistance to districts for transportation costs, capital construction, libraries and media centers—and any number of other types of categorical programs and projects. Since these types of programs are usually intended to enrich the regular school programs, restrictions are placed on categorical funds to prevent districts from merging them with their regular operating funds.

Taking into consideration the fact that state governments must also assume responsibility for substantial

inputs into institutions at the postsecondary level (state universities, junior colleges, grants and loans to students), it is apparent that state education funds are scarce resources in a highly competitive environment of unmet needs. Those that are distributed through equalization formulas are simply not sufficient to narrow the differences in district per-pupil spending to an acceptable level[5] (see Table 2).

Table 2
Variations in Expenditure Per Pupil by State, 1969-70

	District Minimum	District Maximum		District Minimum	District Maximum
Alabama	$294	$ 580	Montana	$467	$8,515
Alaska	480	1,810	Nebraska	274	3,417
Arizona	410	2,900	Nevada	746	1,678
Arkansas	294	1,005	New Hampshire	280	1,356
California	402	3,187	New Jersey	484	2,876
Colorado	444	2,801	New Mexico	477	1,183
Connecticut	499	1,311	New York	633	7,241
Delaware	633	1,081	North Carolina	467	732
Florida	582	1,036	North Dakota	327	1,842
Georgia	364	735	Ohio	412	1,684
Hawaii	489	489	Oklahoma	309	2,565
Idaho	483	3,172	Oregon	431	4,941
Illinois	390	2,295	Pennsylvania	535	4,230
Indiana	373	961	Rhode Island	531	1,206
Iowa	591	1,166	South Carolina	397	610
Kansas	489	1,572	South Dakota	175	6,012
Kentucky	344	885	Tennessee	315	774
Louisiana	499	922	Texas	197	11,096
Maine	215	1,966	Utah	533	[illegible]
Maryland	634	1,036	Vermont	357	1,517
Massachusetts	454	4,243	Virginia	441	1,159
Michigan	409	1,275	Washington	433	3,993
Minnesota	373	1,492	West Virginia	502	721
Mississippi	321	825	Wisconsin	408	1,391
Missouri	213	1,929	Wyoming	617	14,554

Source: President's Commission on School Finance

[5] Although there is considerable difference of opinion as to what constitutes an acceptable range of variation in per-pupil spending, a range of 10 per cent from the state average has emerged as a desirable target to shoot for. This 10 per cent variation, however, would be in addition to spending differentials based on differences in educational costs and needs (such as those which result from providing special programs and equipment for handicapped children, for example). For a thorough treatment of spending variations based on educational costs and needs, see *Schools, People & Money: The Need for Educational Reform*, the final report of the President's Commission on School Finance (Washington, D.C.: U.S. Government Printing Office, 1972).

The Court Cases

A school finance system based on local property taxes and weakly tempered by state foundation aid (as most school finance systems are) is likely to be challenged in the courts. Whether the challenge is successful or not, and the nature of its success, are highly variable matters. The first wedge to be driven in traditional school financing procedures came in August 1971 with *Serrano v. Priest.*[6]

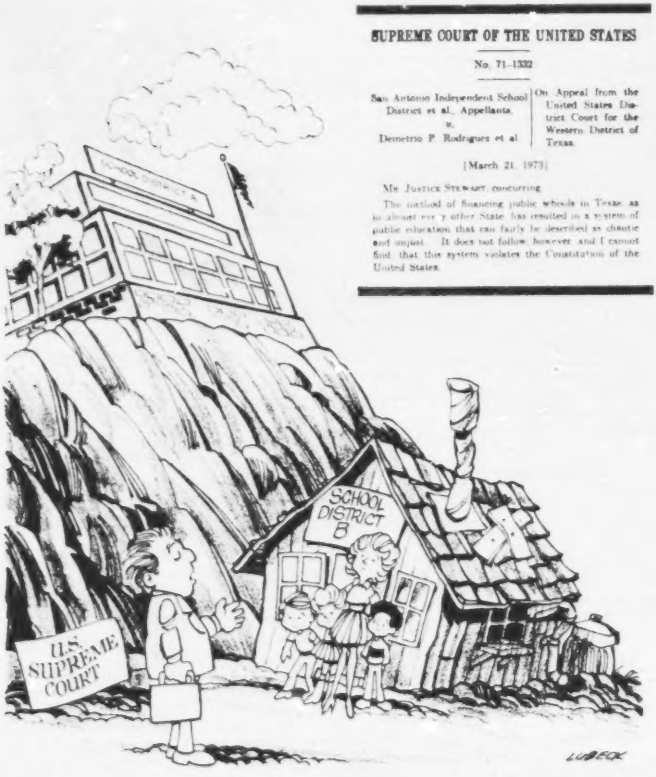
The plaintiffs in the Serrano case were Los Angeles County public school children and their parents seeking "relief against certain state and county officials charged with administering the financing of the California public school system." The California system is typical in that differences in property wealth have led to tax rate differentials and to differences in per-pupil expenditures. The California Supreme Court returned the case to a lower trial court to determine if the allegations of the plaintiffs were indeed factual. If so, ruled the court, "the financial system must fall and the statutes comprising it must be found unconstitutional."

The decision of the California Supreme Court was based in part on the constitution of California and in part on the equal protection clause of the 14th Amendment to the U.S. Constitution. The court found that the California system was in violation of both constitutions. Several months later (December 1971) a U.S. District Court arrived at a similar conclusion regarding the school finance system of Texas (*Rodriguez v. San Antonio Independent School District*).

The Rodriguez decision was also based on state constitutional provisions and on the 14th Amendment. When the case was appealed to the U.S. Supreme Court, however, it was reversed. The court found that the Texas system, also a typical school finance system, did not violate the U.S. Constitution. It pointed to the need for reform, but concluded that "the consideration and initiation of fundamental reforms with respect to state

[6] Lucile Musmanno of the ECS School Finance Project staff is currently preparing a comprehensive analysis of school finance litigation. This publication, *From Serrano to Serrano*, will be available by January 1975.

taxation and education are matters reserved for the legislative processes of the various states, and we do no violence to the values of federalism and the separation of powers by staying our hand."


SUPREME COURT OF THE UNITED STATES
No. 71-1332
San Antonio Independent School District et al., Appellants, v. Demetrio P. Rodriguez et al.
On Appeal from the United States District Court for the Western District of Texas.
[March 21, 1973]
MR. JUSTICE STEWART, concurring.
The method of financing public schools in Texas, as in almost every other State, has resulted in a system of public education that can fairly be described as chaotic and unjust. It does not follow, however, and I cannot find, that this system violates the Constitution of the United States.
SCHOOL DISTRICT B
U.S. SUPREME COURT
LURIE

"Sure, it's unjust, but it's not unconstitutional!"

The Response in the States

By the time Rodriguez was decided, the court's remark was a statement of fact as well as principle. Serrano had served as a catalyst for additional litigation across the country, and state legislatures looked to reform with renewed urgency.[7] The California Legislature, for

[7] See *Major Changes in School Finance: Statehouse Scorecard* by Lucile Musmanno and Alan Stauffer (Denver, Colo.: Education Commission of the States, 1974).

example, passed SB 90, which pumped over $300 million in new state aid into the foundation program. A degree of equity was achieved along with a substantial degree of property tax relief.

The strategy used in California (and in a number of other states) was to limit the amount by which wealthy districts could increase their spending levels while, at the same time, providing additional state aid to poor districts.[8] As a result of the increase in state aid, poor districts could expect to catch up with wealthy districts over a period of years without putting undue pressure on the property tax. One of the major objections to this approach was the fact that the gap in spending levels could be narrowed only over a period of time—10 years was projected in the case of California—and, where voters were permitted to exceed the state-established limit, as they were in California, the gap might not close at all.

Other states have adopted programs that are designed to equalize the *power* of districts to spend rather than to equalize *spending levels.* "District power equalizing" is a program that guarantees that a given tax rate will produce a guaranteed amount of revenue per pupil regardless of the size of the property tax base. In its ideal form, district power equalizing contains "recapture" provisions. If a district has sufficient property wealth to collect more revenue per pupil from a given tax rate than the state has guaranteed, the state

An Example of District Power Equalizing (DPE)

			DPE With Recapture		DPE Without Recapture	
	Tax Rate	Local Revenue Per Pupil	State Aid	Revenue Per Pupil	State Aid	Revenue Per Pupil
District A	15	$ 600	+ $400	$1,000	+ $400	$1,000
District B	15	$1,400	−$400	$1,000	-0-	$1,400
District C	15	$1,000	-0-	$1,000	-0-	$1,000

In this example, the average tax rate is 15 mills and the average per-pupil expenditure is $1,000 (District C represents an average district). With recapture provisions, the cost to the state of equalizing expenditures can be reduced to zero. Without recapture provisions, equalization does not occur and the cost to the state increases.

[8] A limitation was also placed on spending increases in poor districts, but a greater rate of growth was permitted.

recaptures the excess. Most states, however, guarantee the specified yield to poor districts with funds from state revenue sources and allow wealthy districts to retain all locally raised revenue.[9]

The states, then, have been active. School finance reform is under way, in varying degrees, in Arizona, California, Colorado, Florida, Illinois, Kansas, Maine, Michigan, Minnesota, Montana, New Jersey, New Mexico, North Dakota, Utah, Wisconsin and Wyoming. But school finance reform has required an increase in spending at the state level regardless of the type of reform and/or the degree of property tax relief.[10] Those states that have initiated reforms have almost universally had budget surpluses. General revenue sharing funds from the federal government have provided a degree of financial latitude for state governments. Without fiscal capacity and financial flexibility, reform programs would have been seriously curtailed and perhaps impossible.

The Federal Role

Because education is a state responsibility, the federal government has played a rather limited role in the education system. In terms of dollars, the federal contribution ranges between seven and eight per cent of total spending for elementary-secondary education. This sum of money, however, has provided a significant incentive for state and local officials to undertake the types of programs that have been designated by the Congress as "areas of national concern." The most

[9] A notable exception is Maine. The new school finance law adopted by Maine in 1973 bases state funding on the district power equalizing concept with provisions for recapture.

[10] State revenue considerations have been part of the reason that the full state funding (FSF) of education has not been adopted as a reform measure. Under this proposal, the state would levy the taxes for education from state tax instruments (including, possibly, a statewide property tax). The legislature would then distribute funds for education on an equitable basis and in accordance with educational costs and needs. Obviously this proposal would require a rather considerable restructuring of most state-local revenue systems. The objection has also been voiced that full state funding, which would transfer education funding decisions from the local to the state level, represents an undesirable erosion of local control. Although no state has adopted FSF in recent years as a response to school finance problems, this method of financing education has been in operation in Hawaii since 1840.

heavily funded federal education program is Title I of the Elementary and Secondary Education Act (ESEA), which provides compensatory education programs for disadvantaged children. This program, like most of the federal categorical programs, is administered by the U.S. Office of Education.

School finance reform has increasingly been regarded, by both the executive and legislative branch, as an area of national concern. In recent years, legislation has been introduced to deal with one or more of the problems that have resulted from existing school finance methods.[11] Although no clearly defined federal role in school finance reform has yet emerged, the way has been paved for such a role and some progress has been made.

In particular, the passage of PL 93-380 (the Education Amendments of 1974) marked the entrance of the federal government into school finance reform. In Title VIII of the act, provision is made to reimburse state governments for the expenses incurred in drawing up equalization plans (i.e., plans which, if implemented, would result in equalizing per-pupil expenditures within the state but which would take into consideration differences in education costs and needs).

A second feature of PL 93-380 that is designed to encourage school finance reform is the amendment of existing impact aid law. Impact aid is provided to school districts under PL 874 and PL 815 to replace revenue lost when federally owned, tax-exempt property is located within the district. Before the passage of PL 93-380, state governments were not permitted to count impact aid as a local resource when distributing state aid.

This restriction created serious problems for states that were attempting to equalize per-pupil spending. They were required to provide impacted districts with sizable amounts of aid because when districts contained extensive amounts of federally owned property, their local

[11] See *Federal Options in Education Finance Reform: A Review of Bills Before the Congress* by the author (Denver, Colo.: Education Commission of the States, 1974).

property tax base was, of course, quite small. The district was then entitled to large payments from the state in addition to impact aid from the federal government. Local taxpayers were able, sometimes at very minimal tax rates, to spend well above the state average per-pupil expenditure. The provision prohibiting states from counting impact aid as a local resource was revised in PL 93-380 for those states that have adopted equalization programs.

The federal contribution to school finance reform has, to date, three distinctive features. First, general revenue sharing funds, which have provided state governments with a greater degree of financial flexibility, have been a positive force in promoting reform. Second, recent legislative initiatives and the passage of PL 93-380 indicate that the Congress is willing and able to provide assistance and encouragement to states that undertake school finance reform. Finally, the U.S. Supreme Court decision in the Rodriguez case has served to reinforce tradition by leaving school finance reform a function of state government.

Looking Ahead

In spite of the impressive advances made by the states, school finance reform has suffered some setbacks and has become increasingly complex. In Florida, extensive school finance reform legislation was passed in 1973. It is now under attack in the courts. In April 1974, the trial court ruled in the Serrano case that the California finance system, including the new program that resulted from the passage of SB 90, violated the equal protection clause of the California Constitution.

The question of whether a school finance system could be struck down as a violation of state constitutional provisions alone had already been determined. The New Jersey system had been found to be in violation of the New Jersey Constitution in *Robinson v. Cahill* just a few short weeks after the U.S. Supreme Court ruling on *Rodriguez.* The New Jersey Legislature was given a deadline (December 1974) and ordered to produce a system that satisfied the requirements of the state constitution. As the trial court in California made clear, state constitutions could be expected to require more in

the way of reform than simply providing additional support for the foundation plan and property tax relief.

A second round of court decisions has further compounded school finance problems. These decisions have made it clear that handicapped children must be provided with a public education suited to their needs (*Pennsylvania Association for Retarded Children v. Commonwealth of Pennsylvania*) and that non-English speaking children must be provided with an education that they can comprehend (*Lau v. Nichols*). The expansion of special education and bilingual education programs can, of course, be expected to have a significant impact on school finance and on the problems associated with it. Another chain of litigation and legislation with financial overtones is taking place in the field of collective bargaining as teacher unions respond to the pressures of inflation.

In fact, declining school enrollment is perhaps the only recent development that augurs for lower education spending—but not necessarily for fewer problems. Some districts, for example, are in the unfortunate position of paying for schools that are underutilized or empty. Many of the poorer districts, struggling to improve the quality of their educational program, fear a decrease in state aid and local support as a result of declining enrollments.

The 1971 *Serrano* decision ushered in an era of new concern across the nation about our methods of financing education. The U.S. Supreme Court has spoken, state legislatures have acted and so has the Congress, and court cases in a number of states continue to serve as catalysts for further reform. However, like the mythological monster that sprouts two heads for every one that is chopped off, school finance reform has become broader in its concerns and has proven itself difficult to bring to any final, successful conclusion.

One Last Word

This brief overview of school finance reform has been written for legislators. It is intended to point to one very obvious fact—that when it comes to school finance

reform, the spotlight is on the state legislature. To quote again from *Rodriguez:*

> We hardly need add that this Court's action today is not to be viewed as placing its judicial imprimatur on the status quo. The need is apparent for reform in tax systems which may well have relied too long and too heavily on the local property tax. And certainly innovative new thinking as to public education, its methods and its funding, is necessary to assure both a higher level of quality and greater uniformity of opportunity. These matters merit the continued attention of the scholars who already have contributed much by their challenges. But the ultimate solutions must come from the lawmakers and from the democratic pressures of those who elect them.

Suggested Readings

Advisory Commission on Intergovernmental Relations, *Financing Schools and Property Tax Relief: A State Responsibility*, Commission Report No. A-40 (Washington, D.C.: U.S. Government Printing Office, 1973).

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